How to Manage Your Business in a Recession

There's no script for running a company in this historic downturn. So what the heck do you do? Here are ten ways to weather the storm.

By Geoff Colvin

Exciting as it is to be living through historic economic drama, you can't just stand by and watch. You have to act—yet you have no script. So much of today's turmoil is unprecedented that we can't find much guidance by looking to the past. For managers across the global economy, as well as for Team Obama on its way to Washington, today's great question is, What do we do now?

Managing in any recession is difficult; managing through this one is especially hard because it's different from previous ones in multiple ways. Most immediately significant, employment is plunging more steeply than in a long time—by more than two million jobs last year, more than during the previous two recessions, and this one is far from over. At the same time, U.S. consumer spending is falling sharply. In the third quarter it sank at a 3.1% annual rate, the steepest decline since 1980—meaning that managers who have made it through the past four recessions have never confronted anything like it. Best Buy president Brian Dunn said recently, "In 42 years of retailing, we've never seen such difficult times for the consumer."

The drop is worrisome because consumer spending is more than 70% of America's economy, and while it may rise quickly or slowly, it almost always rises. During the whole of the last recession (2001), consumer spending never declined at all; its growth only slowed. Compounding the problem, consumers are more deeply in debt than ever, an immediate concern for companies that lend to consumers; American Express CEO Ken Chenault

PHOTOGRAPHS BY DAVID YELLEN

calls this "one of the most challenging economic environments we've seen in many decades." Longer term, consumers' balance sheets are so ugly that many executives believe this recession may linger as people slowly rebuild their finances. Dunkin' Brands chairman Jon Luther says, "This downturn will not have a typical V-shape, where it bounces right back. It could be a couple of years before consumer spending goes up again."

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JAMIE DIMON, CEO, J.P. MORGAN CHASE

Consumers aren't the only ones deleveraging. Companies are too, and on a more massive scale than ever seen before. That means business-to-business firms are also suffering. Cisco CEO John Chambers predicts that his company's sales will decline for the first time in five years. Deleveraging is typical in a recession, but because boom-time leverage had reached unprecedented levels, the reverse process may become particularly violent. Deere CEO Bob Lane cites current deleveraging as a main difference between this recession and previous ones: "The U.S. economy has never been through anything like this, and we don't know what the effects will be."

Yet another important difference—the credit crunch—affects even those companies that are reducing debt, but especially those that aren't. Virtually all firms depend on a constant flow of credit to carry them smoothly through the ups and downs of business fluctuations. While it's entirely typical for lenders to get more cautious in a downturn, the near freezing of credit is something else again. Even companies able to pay higher interest rates may find that credit isn't available from the usual sources at any price.

WHOLE FOODS THE COMPANY USED TO BUILD ECONOMIC GROWTH INTO PLANS BUT NO LONGER MAKES THAT ASSUMPTION.

Making this recession unique above all is its sheer interconnected complexity. Consider this sequence: The U.S. housing bubble bursts, pushing U.S. consumer spending down, leading to less demand for imports from China, causing slower growth of the Chinese economy, thus decreasing demand for copper, pushing copper prices down to their lowest levels in almost three years, causing big problems for you and your warehouse full of copper. You can conduct pretty fancy scenario planning and still not be ready for that—and it's safe to say we've barely begun to see the rippling effects of a recession in an information-based, truly international economy.

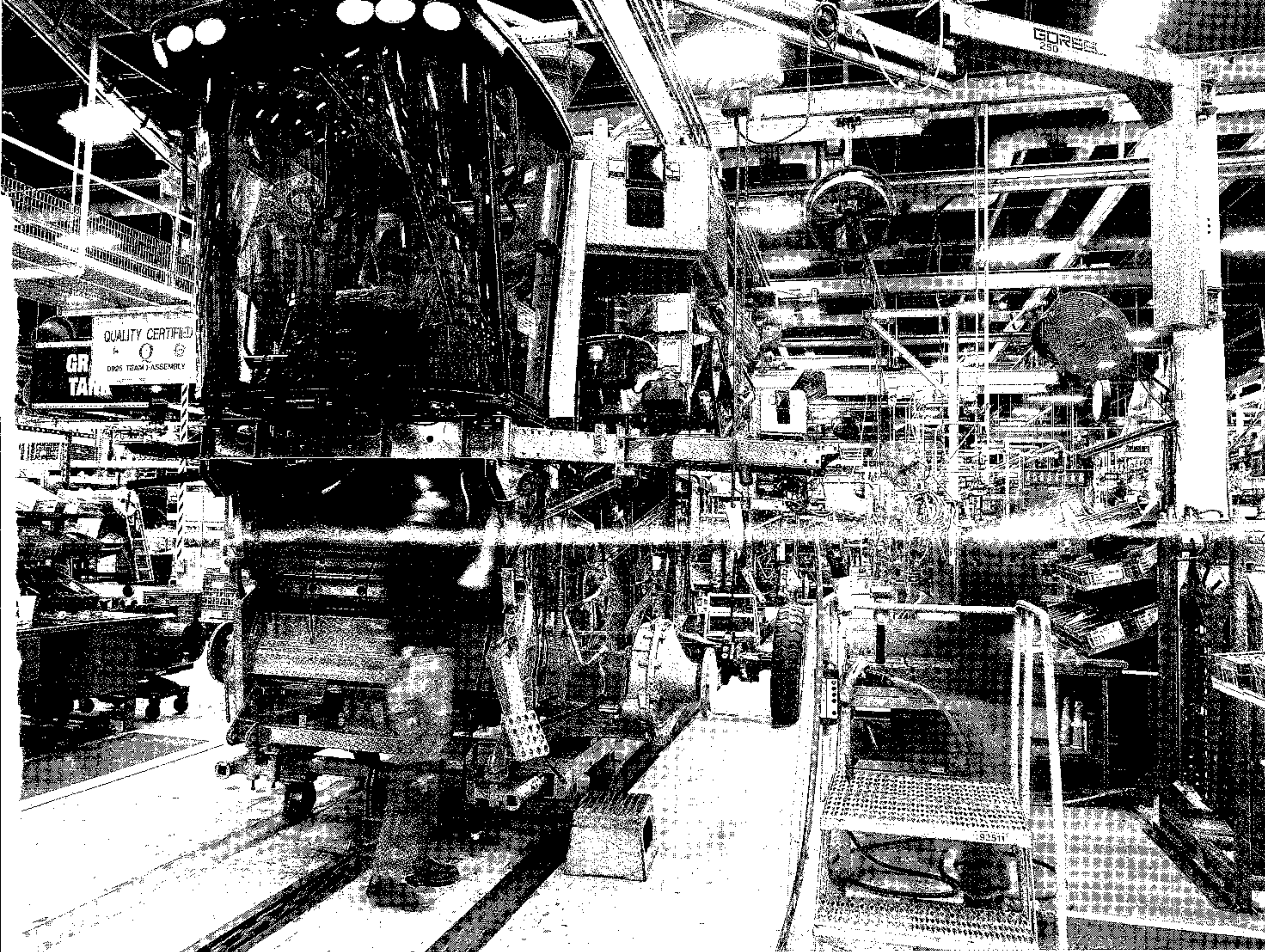
Yet that's the environment in which you must manage. How? Insights and practices from global executives, consultants, and others suggest several steps you can take now. As usual in these situations, much will depend on how quickly you move. It's human nature to avoid confronting bad news and to imagine that today's troubles will pass more quickly and easily than they really will. Virtually everyone *Fortune* spoke to recommends the opposite: Assume conditions will be worse than you actually expect. "You identify areas where you think you can be more efficient by assuming the worst-case scenario," says Intuit CEO Brad Smith. "Then you end up saying, Why don't we just do that anyhow?" Facing the coming reality before your competitors do can make a big difference in which of you stays healthy or even who survives.

It must be said that some of the most effective moves you can make for prospering through a recession are ones you established a long time ago. In times like these the strong get stronger and the weak get eaten. In the tumultuous third quarter, while Washington Mutual and IndyMac Bank were failing, Bank of America—which got out of subprime mortgages in 2001—attracted $21 billion of new consumer deposits as consumers ran to safety. When the Wickes furniture retailing chain filed for bankruptcy earlier this year, more than 100 truckloads of furniture were on their way to its stores; a Milwaukee retailer that had remained financially solid, Steinhafels, bought the contents of several at bargain prices.

Remember that for next time. For now, what's done is done. No matter what shape your business is in, it will benefit from following these ten recommendations.

Reset priorities to face the new reality.

Easy to say, hard to do. When a company's view of the world changes, everything changes, and the shift can be traumatic. In good times the top priorities may be expanding into new markets,



DEERE THE FARM EQUIPMENT MAKER (HERE IN EAST MOLINE, ILL.) HAS TRIED TO AVOID INVENTORY BUILDUPS BECAUSE OF UNCERTAIN DEMAND.

hiring enough people, and growing earnings 15%. Suddenly changing direction may seem drastic, but it must be done. Jamie Dimon, CEO of J.P. Morgan Chase, one of the nation's few remaining strong major banks, recently told a group at the Harvard Business School, with regard to the recession, "I am shocked at the number of people who are watching that train coming down the track, and they're still worrying about their strategic plan for 2009. We canceled all that stuff—all of it—meetings, travel, you name it, to focus on the fact that we're in the middle of a real crisis."

Whole Foods Market CEO John Mackey says, "We have to manage the business differently." Economic growth used to be a tail wind that the company built into its business plans. Now, says Mackey, "one of the leadership challenges I have is that that assumption is no longer true." The new era "requires a different mindset—we have to be more frugal, to think about every expense, every capital investment—because we won't be bailed out by growth."

Keep investing in the core.

Recessions end, and much of the art of recession management involves remembering that fact. When this lousy stretch is over, will your business be more competitive or less? The most successful companies never stop funding their most critical competencies—product innovation, customer service, or anything else. Kohl's, the big retailer, actually spent more on marketing this past holiday season than it did last year. Intuit's Smith says, "We're not going to cut innovation. This company for 25 years has been fueled by new-product innovation. We're protecting the innovation pipeline so we come out of this strong." For virtually all companies, a critical part of the core is the continual development of employees. Yet it's remarkable how many businesses cut training and development in a downturn. The best never do.

Communicate like crazy, balancing realism and optimism.

The instinct of most executives is to hunker down in uncertain times, keeping quiet until they believe they have some answers. That's the opposite of what's needed. In a recession all of a company's constituencies are nervous: Employees are worried that they'll be fired, suppliers that they won't be paid, customers that quality will decline or prices rise, investors that the stock will tank, communities that operations will close down. Your silence just makes them worry more.

Good managers respond by communicating even more than usual. They find that they needn't have all the answers, but they

do need to say what they're thinking and be honest about conditions. Julia Stewart, CEO of DineEquity, parent of the Applebee's and IHOP restaurant chains, says, "It's important to assure your employees by making clear your vision, making sure they know that you care, and making sure that you're direct and honest. They just want the truth."

Even when the news isn't good—which it usually isn't—effective leaders find ways to keep hope alive. Home Depot chief Frank Blake cites an observation by Colin Powell: "Optimism is a force multiplier." Conditions are especially brutal for Home Depot, and last year Blake closed 15 U.S. stores and cancelled 50 on the drawing board. But he reminds everyone that the company is around for the long haul and intends to stay strong. John Hammergren, CEO of the giant pharmaceutical distributor McKesson, has been holding employee town halls, where his goal is "to give confidence that we're in a great industry, and McKesson is in a leadership position." Every good company has upbeat facts, even in a recession, and they need to be repeated.

Your customers face new problems, so give them new solutions.

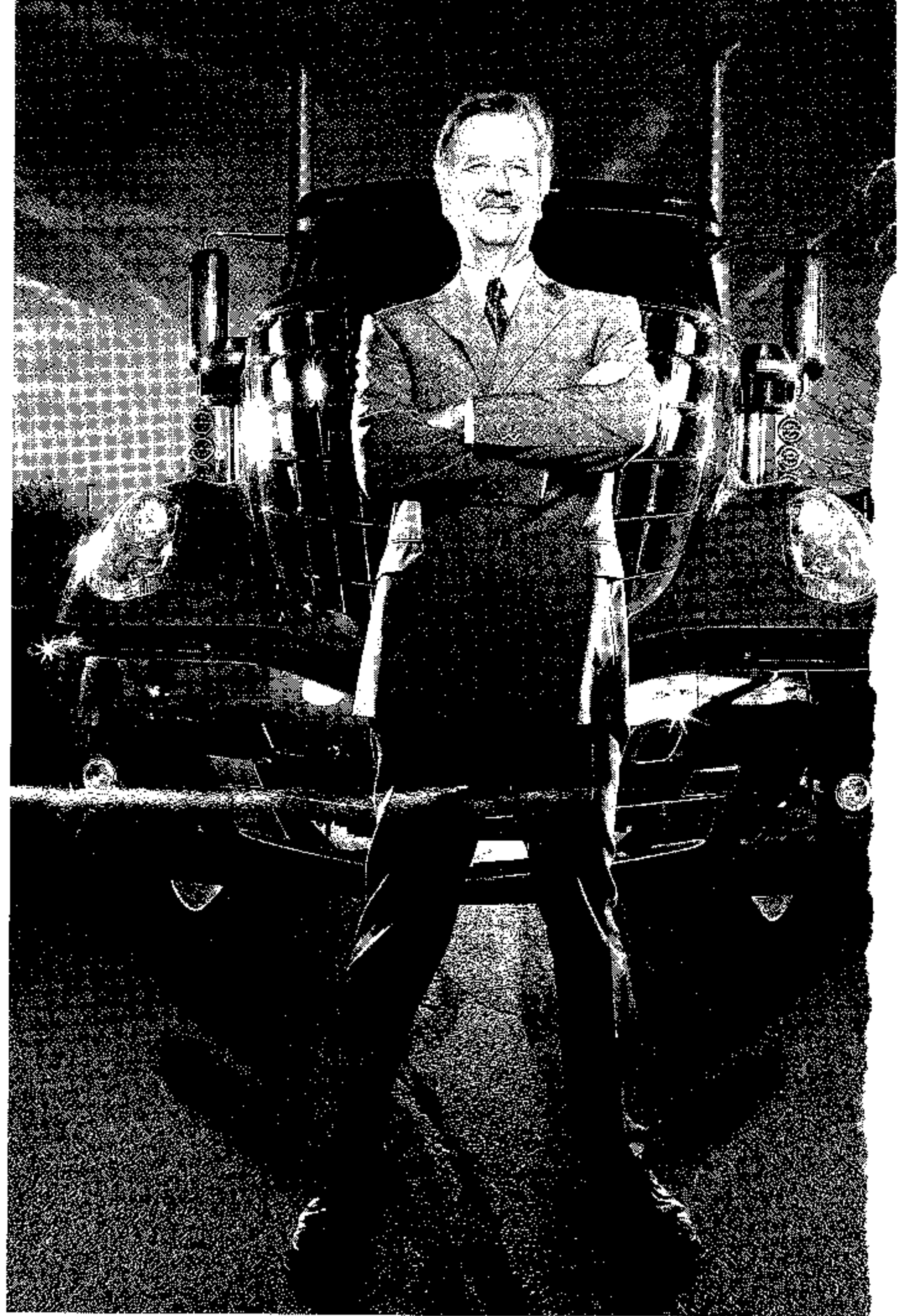
The best performers deeply understand their customers' businesses and can respond in sophisticated ways. For example, McKinsey reports that when the economy was booming, a client company that sells plastic resins developed a fast-curing resin for customers that wanted maximum productivity from their injection-molding machines. But when the economy turned down and clients no longer needed as much output from their machines, the company developed a less expensive, slower-curing resin. Customers are happy because their costs have fallen, and since the new product is cheaper to make, the company maintains its profit margins even when selling at a lower price.

In any industry the general principle is helping customers make the most of what they've got. McKesson's customers include big retailers that are under pressure to cut costs as consumers grow stingier. For those retailers, negotiating significant cost reductions from suppliers of generic drugs is tough, so McKesson offers them this proposition: Just buy all your generics from us and redeploy your purchasing team to projects where it can achieve bigger savings. Both parties win.

No matter what business you're in, you can redefine value for the customer. When the economy was strong, CKE Restaurants, parent of the Hardee's and Carl's Jr. chains, developed a winning strategy based on massive burgers at premium prices. Reacting to the recession by suddenly selling skinny burgers cheap would destroy the company's market position, so it's responding in other ways. "We can't add meat to a burger anymore," says CKE marketing chief Brad Haley, since the cost is too high. "We have to be more creative. Carl's Jr. is promoting a guacamole bacon cheeseburger. Avocados are a less expensive topping."

Don't rush to cut prices.

Yes, everyone would like to pay less, especially in a recession, but the dangers of price chopping are greater than you may realize.



NAVISTAR CEO DAN USTIAN, HERE WITH A LONESTAR TRUCK, MANAGES CAPITAL EFFICIENTLY BY BUYING ENGINES FROM OTHER COMPANIES.

McKinsey research finds that in a typical S&P 1500 company, a price cut of 5% would have to generate increased sales volume of 19% in order to pay for itself—and that almost never happens. The implication is that while holding prices steady may cause sales to decline somewhat, that course may nonetheless be wiser. It all depends on the pricing dynamics in your business, which may be changing rapidly in this recession. For example, gasoline at $4 a gallon caused many U.S. consumers to cut back drastically on discretionary purchases; since gas today is below $2, some consumers may have more available income—but may also be more worried about their jobs. Now is the time to study price sensitivity in your markets much more closely than before.

Focus on capital—how you're getting it and where you're using it.

In good times, and especially in a period of low interest rates, it's easy to get lax about capital and to forget the most fundamental rule of business: that you must earn a return on capital that exceeds your capital's cost. That error really hurts now that capital markets have become tight. The unprecedented seize-up of the commercial paper market in September and October forced many companies to rethink all their sources of capital. Dunkin'

REPORTER ASSOCIATES *Steven Gray, Christopher Tkaczyk, and Yi-Wyn Yen*

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Brands, which had previously turned to the largest national financial institutions for capital to help franchisees finance new stores, is now finding that healthy regional banks are also a good source.

Companies that are managed explicitly for capital efficiency are stronger now than they would be otherwise. Dan Ustian, CEO of truckmaker Navistar, no longer invests the $350 million to $400 million needed to develop a new engine; instead he buys from others and says he spends $30 million to $40 million optimizing "controls, software, and air-fuel management" to make the engines work best in his trucks. "It's our capital ethos," he says. "We don't need to make another investment." Similarly, knowing that inventory represents warehouses full of capital, Deere avoided the inventory pileups that afflict many manufacturers in a downturn and that have especially hurt the Detroit automakers.

Reevaluate people—and steal some good ones.

Just as most investment managers look like geniuses in a bull market, most employees can look like excellent performers in a booming economy. Now is when you identify the impostors. Working hard at that task is important, because if you need to lay people off, as you well may, it's critical that you choose wisely. A subtler danger: If salaries or bonuses need to get whacked, you may be tempted to reduce them equally across the board in an effort to show that we're all in this together. But think of the message that practice sends to your best performers, who will feel they're being punished rather than rewarded for their great work. Mel Stark of the Hay Group consulting firm points out that in his survey of the World's Most Admired Companies as ranked by *Fortune*, the best ones take extra pains to reassure their "most driven and focused employees," the ones it is most important to keep. Instead of spreading the pain, reward your best workers well, even in a recession. Then scout for competitors that are sharing the misery equally and steal their best performers.

Reexamine compensation—what is it offering incentives for?

A widespread criticism of the Wall Street firms that stumbled or fell in the financial crisis is that their pay programs encouraged too much risk; executives had much to gain if their high-risk bets paid off and little to lose if they didn't. In fact, Washington's $700 billion rescue package specifically requires that incentive compensation at the affected firms must not "encourage unnecessary and excessive risks that threaten the value of the financial institution."

While you're making sure that pay arrangements at your company don't encourage too much (or too little) risk, think more broadly about what they encourage. At Deere, for example, incentives are based on economic profit, a measure that includes capital costs, and bonuses earned in any given year are paid out over four years; if performance falters, part of the bonuses can be canceled. The system encourages long-term thinking and seeing the recession as part of a larger cycle.

Think twice about offshoring.

A time of greater cost pressures may seem an odd moment to ask whether offshoring still makes sense, but in fact the economics have changed drastically. The labor-cost advantage of manufacturing in China or Malaysia has shrunk as wages in those countries have jumped, and now that U.S. unemployment is increasing, the wage gap in some industries may shrink further. The price of oil, while down from its peak, is still much higher than five years ago and unlikely to fall much more, in the view of many analysts, so transportation costs may also cut into offshoring's edge. Combine all the factors and now may be a smart time to bring manufacturing back, or at least closer, to the U.S. McKinsey found, for example, that a midrange computer server could be made for much less in Asia than in the U.S. in 2003, but by last year the cost advantage had reversed, so that making the machine was actually cheaper in America.

Manufacturing costs aren't the only factor in an offshoring decision. Taxes, tariffs, speed, and transition costs can make a big difference. But at a time when costs count more than ever, don't assume that offshoring is still your best option.

Be smart about mergers and acquisitions.

It seems obvious that a recession is a great time to buy assets cheap. The wonder is that so few companies do it. Merger activity tends to peak when markets are at their height, while most companies see a recession as a time to hoard resources until things improve. Companies are twice as likely to acquire businesses in their major segments during an upturn as they are during a downturn, the opposite of what makes sense.

Of course if you're strapped, you can't follow Warren Buffett's dictum to be greedy when others are fearful. But if you're financially strong, this is your moment. McKesson's Hammergren says, "This is a great opportunity to pick up small companies and their talent," for which he is scouting avidly.

IT'S HARD TO BE UPBEAT ABOUT A RECESSION, but it truly is an opportunity. Marathoners and Tour de France racers will tell you that a race's hardest parts, the uphill stages, are where the lead changes hands. That's where we are. When this recession ends, when the road levels off and the world seems full of promise once more, your position in the competitive pack will depend on how skillfully you manage right now. ■

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